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Cases, Regulations, and Statutes

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[23] *Id*.

[24] *Id*.

[25] Rev. Proc. 2004-22, I.R.B. 2004-15.

[26] *Id*.

[27] I.R.C. § 223(d)(2)(A).

[28] I.R.C. § 223(d)(2)(C)(i).

[29] I.R.C. § 223(d)(2)(C)(ii).

[30] I.R.C. § 223(d)(2)(C)(iii).

[31] I.R.C. § 223(d)(2)(C)(iv).

[32] I.R.C. § 223(f)(8)(A).

[33] *Id*.

[34] I.R.C. § 223(f)(8)(B).

[35] I.R.C. § 223(f)(8)(B)(ii)(II).

[36] I.R.C. § 223(f)(7).

[37] I.R.C. § 223(c)(1)(A).

[38] Notice 2004-2, I.R.B. 2004-2, 269.

[39] Notice 2004-25, I.R.B. 2004-15.

[40] I.R.C. § 106(d)(1).

[41] Notice 2004-2, I.R.B. 2003-269.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

DISCHARGE. The debtor owed a judgment awarded in a patent infringement lawsuit against the debtor for saving and using seeds from cotton and soybean plants grown from genetically modified cotton and soybean seeds without paying additional licensing fees. The jury found that the debtor willfully infringed upon the seed producer's patented seed technology. The seed producer sought to have the judgment award declared nondischargeable under Section 523(a)(6) for willful and malicious injury to the creditor's property. Although the debtor admitted that the jury finding established the element of willfulness, the debtor denied that the patent infringement was malicious. The Bankruptcy Court held that the producer failed to demonstrate that the debtor's action in saving and planting the seed from the genetically modified seed plants was done with intent to harm the seed producer. Therefore, the judgment was dischargeable. The appellate court reversed on the issue of maliciousness, holding that the debtor had to know that the debtor's actions would harm the producer. In addition, the court noted that patent infringement was an intentional tort. ***In re* Trantham, 304 B.R. 298 (Bankr. 6th Cir. 2004), *rev'g in part*, 286 B.R. 650 (Bankr. W.D. Tenn. 2002)**.

CHAPTER 12

SECURED CLAIMS. The debtor's estate included 40 acres of rural land, 22 acres of which was tillable land and 17 acres of which was marshland. The land secured a claim which exceeded the value of the land. The debtor's plan provided for the retention of the land and payment of the secured claim according to a value of the land determined entirely as farmland. Because the marshland was not tillable, the debtor's valuation was based primarily on the value of the tillable land and residence. The secured creditor argued that the value of the land was higher, based on a value of the entire property at its highest and best use. The court agreed with the creditor and held that the land had to be valued at its replacement value and the value could not be restricted to the use of the debtor or a similar buyer. ***In re* Bell, 304 B.R. 878 (Bankr. N.D. Ind. 2003)**.

FEDERAL TAX

REFUND. The debtors' chapter 13 plan was confirmed and provided for payment of all disposable income to unsecured creditors. The IRS had general unsecured claims and the taxes were to be paid only from plan funds. The debtor became entitled to an income tax refund during the plan which was paid by the IRS. The IRS then sought a turnover of the refund and a modification of the plan to include the refund in the unsecured claims payments. The court denied the IRS motion because the IRS did not provide specific plan revisions to guide the court in determining the amount of the refund eligible for payments to unsecured creditors. ***In re* Breeden, 304 B.R. 318 (Bankr. N.D. Ohio 2003)**.

TAX LIEN. The debtor had filed for Chapter 7 and the debtor's taxes for 1987, 1989 and 1991 were discharged. However, the IRS had filed a pre-petition tax lien for the discharged taxes which attached to the debtor's interest in a 401(k) pension plan. Five years after the bankruptcy discharge, the IRS filed a notice of intent to levy against the debtor's interest in the pension plan. The court held that the tax lien survived the discharge of the debtor's personal liability for the taxes and the lien could be executed by levy against any non-exempt property held by the debtor which was subject to the lien. Because the interest in the 401(k) plan was not exempt from levy, the court held that the levy was proper. **Iannone v. Comm'r, 122 T.C. No. 16 (2004)**.

CONTRACTS

CONTRACT DAMAGES. The plaintiff purchased seed potatoes from the defendant. The sales contract specified that the defendant was to provide certified Superior potatoes. Because of flooding of the defendant's fields, the defendant delivered Atlantic potatoes which are indistinguishable from Superior potatoes at the seed potato stage. The error was not discovered until the potatoes were harvested. Because Superior potatoes have a higher value, the plaintiff sued for breach of contract and breach of implied and express warranty. The sales agreement contained a damages limitation clause that limited the defendant's lability under the contract to the purchase price of the seed potatoes. The plaintiff argued that the damage limitation clause should not be enforced because the defendant failed to provide the type of potatoes specified by the contract, not merely that the seed potatoes were not of the same type and quality. The court disagreed and held that the damages clause was enforceable because it provided a reasonable benefit for the failure of the defendant to perform as contracted. **Bernath v. Potato Services of Michigan, 300 F. Supp.2d 175 (D. Me. 2004)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The FCIC has adopted as final regulations adding to the Common Crop Insurance Regulations the Sunflower Seed Crop Insurance Provisions, Coarse Grains Crop Insurance Provisions, Safflower Crop Insurance Provisions, Dry Pea Crop Insurance Provisions, Rice Crop Insurance Provisions, Dry Bean Crop Insurance Provisions, and Canola and Rapeseed Crop Insurance Provisions to implement the quality loss adjustment procedures contained in Section 10003 of the Farm Security and Rural Investment Act of 2002. **69 Fed. Reg. 23417 (April 29, 2004)**.

LIVESTOCK DISASTER ASSISTANCE. The CCC has announced the availability of $500,000 under the California Livestock Indemnity Program to provide assistance to producers who suffered livestock losses due to wild fires in Southern California. The notice also provides instructions on how to apply for the assistance. **69 Fed. Reg. 23721 (April 30, 2004).**

ORGANIC FOODS. The AMS has issued proposed regulations which would exempt any person producing and marketing solely 100 percent organic products from paying assessments to any research and promotion program administered by the AMS. In the explanation and examples, the AMS points out the 100 percent requirement applies to the producer's entire operation, not for each commodity. Thus, a farmer who grows all organic soybeans but also grows nonorganic corn is not exempt from assessment under the soybean promotion, research and consumer information program. **69 Fed. Reg. 22690 (April 26, 2004)**.

TUBERCULOSIS. The APHIS has adopted as final regulations that change a portion of Michigan from modified accredited to modified accredited advanced under the bovine tuberculosis regulations. **69 Fed. Reg. 20805 (April 19, 2004)**.

FEDERAL ESTATE AND GIFT TAXATION

MARITAL DEDUCTION. The decedent had created an irrevocable trust which was intended to qualify as QTIP upon the death of the decedent. The trust provided for a lifetime interest for the surviving spouse with the remainder to a charity. The surviving spouse, however, challenged in state court the wording of the trust as not complying with a prenuptial agreement. The spouse and charity entered into an agreement which modified the trust provisions. The IRS ruled that the property passing to the spouse under the modified trust was QTIP because the modification was the result of a bona fide challenge to the trust and the settlement was reached under arm's-length negotiations. **Ltr. Rul. 200417030, Jan. 16, 2004**.

FEDERAL INCOME TAXATION

"AT RISK" LOSS LIMITATION. Under I.R.C. § 465(b)(3), amounts borrowed for use in an activity will not increase the borrower's amount at risk in the activity if the lender has an interest other than that of a creditor in the activity or if the lender is related to a person (other than the borrower) who has a disqualifying interest in the activity. The rule applies even if the borrower is personally liable for the repayment of the loan or the loan is secured by property not used in the activity. I.R.C. § 465(c)(3)(D) provides that I.R.C. § 465(b)(3) will apply to new activities only to the extent provided in regulations. The Tax Court in *Alexander v. Commissioner, 95 T.C. 467 (1990)*, held that, until regulations are issued, Section 465(b)(3) could not be applied to a new activity. The IRS has adopted as final regulations which apply I.R.C. § 465(b)(3) to the new activities described in I.R.C. § 465(c)(3)(A). As originally enacted, I.R.C. § 465(b)(3) also applied to any borrowing from persons related to the taxpayer under I.R.C. § 267(b). Section 432(c) of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) eliminated this rule but provided, instead, that a taxpayer's amount at risk is not increased by amounts borrowed from a person related to a person (other than the taxpayer) who has a disqualifying interest in the activity. The regulations change Prop. Treas. Reg. § 1.465-20 to reflect the amendment made by the Deficit Reduction Act of 1984. The regulations also modify the previous proposed regulations to reflect I.R.C. § 465(b)(3)(B)(ii), which provides that, for purposes of determining a corporation's amount at risk, an interest as a shareholder is not a disqualifying interest. Thus, amounts borrowed by a corporation from its shareholders may increase the corporation's amount at risk. The regulations also modify the previous proposed regulations to reflect I.R.C. § 465(b)(6)(A), which provides that "qualified nonrecourse financing," if borrowed for use in an activity of holding real property and secured by real property used in the activity, is not subject to the limitations of Section 465(b)(3). In addition, the regulations expand the exception to include financing that, if it were nonrecourse, would be financing described in Section 465(b)(6)(B). **TD 9124, 69 Fed. Reg. ____ (May _, 2004)**.

CORPORATIONS.

REORGANIZATIONS. The IRS has issued proposed regulations which remove Treas. Reg. §§ 1.358-2(a)(2) through (5) and (c) and replace these provisions with a more complete set of rules for determining the basis of each share or security received in a reorganization described in section 368 and a distribution to which section 355 applies. These proposed regulations generally provide that the basis of each share of stock or security received in an exchange to which I.R.C. § 354, 355, or 356 applies will be the same as the basis of the share or shares of stock or security or securities exchanged therefor. The determination of which share of stock or security is received in exchange for, or with respect to, a particular share of stock or security will be made in accordance with the terms of the exchange or distribution. The new regulations reject the method of basis allocation of *Arrott v. Commissioner*, 136 F.2d 449 (3d Cir. 1943), where the court reasoned that the shares surrendered in an acquisitive reorganization lost their identity when traded for new shares in the reorganization and held that the basis of the shares acquired was determined by averaging the basis of the shares exchanged. **NPRM REG-116564-03 (April 30, 2004)**.

DEPRECIATION. The taxpayer purchased the right to produce a product under a patent license agreement and to sell the product under a registered trademark. The taxpayer used the taxpayer's own business property to produce and market the product. The IRS ruled that the trademark and patent license were not assets which constituted a trade or business; therefore, the amortization of the trademark and patent license was not governed by I.R.C. § 197 and the intengibles were eligible for depreciation under I.R.C. § 167(f). **Ltr. Rul. 200416002, Dec. 19, 2003**.

ELECTRICITY PRODUCTION CREDIT. The IRS has announced the 2004 inflation adjustment factor (1.2230) and reference prices used in determining the availability of the renewable electricity production credit to taxpayers producing electricity using wind (3.24 cents per kilowatt hour) or closed-loop biomass and poultry waste (zero cents per kilowatt hour). The inflation adjustment factor and reference prices apply to calendar year 2004 sales of kilowatt hours of electricity produced in the U.S. and its possessions from qualified energy resources. The renewable electricity production credit for calendar year 2004 is 1.8 cents per kilowatt hour on the sale of electricity produced from wind, closed-loop biomass, and poultry waste energy resources. **Notice 2004-29, I.R.B. 2004-17**.

EMPLOYEE EXPENSES. The taxpayer had employees who regularly incurred business-related expenses of meals, travel, entertainment and lodging. The taxpayer had arranged for reimbursement of these expenses when properly substantiated by the employees with receipts and expense reports. The taxpayer had company credit cards issued to these employees to pay for the same business-related expenses. The employees were personally liable for any credit card charges. The expenses charged on the credit card accounts were paid by the taxpayer directly to the credit card company after the employee verified the charges and a supervisor reviewed the charges. The IRS ruled that the taxpayer's reimbursement system qualified as an accountable plan under I.R.C. § 62(c) and satisfied the substantiation requirements of I.R.C. § 274(d) and Treas. Reg. § 1.62-2(e)(2). **Ltr. Rul. 200417022, Jan. 6, 2004**.

The taxpayer was a trucking company which paid its drivers a fixed per diem rate for travel expenses based on miles driven. The taxpayer did not keep individual records of travel expenses but used the deemed substantiation rules of *Rev. Proc. 97-59*, *1997-2 C.B. 594*. However, *Rev. Proc. 97-59* treats a per diem allowance as entirely for meals and incidental expenses if the per diem rate is calculated in a manner similar to the employee compensation. Under I.R.C. § 274(n) meals and incidental expenses deductions are limited to 50 percent for the taxpayer's tax year involved here (70 percent in 2004 and 2005 for individuals subject to federal hours of service for food and beverages consumed away from home). Another provision of *Rev. Proc. 97-59* allows a taxpayer to allocate 40 percent of a per diem allowance to meal expenses. The taxpayer argued that this provision allowed the taxpayer to treat the remaining per diem allowance as deductible lodging expenses reimbursement. However, the court noted that the 40 percent allocation of the per diem allowance applies only where the per diem includes a reimbursement for lodging as well as meals and incidental expenses; therefore, the provision was not available for the taxpayer because all of the per diem allowance was treated as only meals and incidental expenses reimbursement under the deemed substantiation rules. The court upheld the validity of the restriction on the 40 percent allocation rule.

In addition, the court noted that, even if the allocation rule requirement was invalid, the lodging reimbursement deduction was not available to the taxpayer because the taxpayer had no records to substantiate the reimbursements for lodging. **Boyd v. Comm'r, 122 T.C. No. 18 (2004)**.

LETTER RULINGS. A taxpayer had obtained a letter ruling from the IRS that fuel produced from coal by the taxpayer was eligible for the credit for nonconventional fuels. The letter ruling was based on expert conclusions provided by the taxpayer; however, the IRS also obtained independent expert opinions which did not agree with the conclusions reached by the taxpayer's experts. In a technical advice memorandum, the IRS ruled that the fuel produced by the taxpayer was not eligible for the I.R.C. § 29(c)(1)(C) credit; however, the IRS also ruled that, because the taxpayer made investments in reliance on the letter ruling, the taxpayer could continue to receive the credit so long as the taxpayer maintained the same manufacturing process and maintained accurate records and testing of the product. **T.A.M. 200416010, Nov. 26, 2003**.

MINERAL ROYALTIES. The IRS had issued an advance notice of *Rev. Proc. 2004-27*, which allowed certain owners of royalty interests (RI Owners) to claim the credit for producing fuel from a nonconventional source under I.R.C. § 29 in the taxable year (including a 2003 taxable year) in which they receive the income from the sale of qualified fuel, rather than in a prior taxable year in which the owner of the operating interest sold the qualified fuel. The advance version of *Rev. Proc. 2004-47* applied only to RI Owners using the cash receipts and disbursements method of accounting. The IRS has since determined that it is appropriate to extend the relief granted in *Rev. Proc. 2004-27* to taxpayers using an accrual method of accounting. Accordingly, *Rev. Proc. 2004-27* as published in *I.R.B. 2004-17*, differs from the version that was advance released in that all references therein to the cash method of accounting have been removed. **Ann. 2004-42, I.R.B. 2004-17**.

PARTNERSHIPS.

RECOURSE LIABILITIES. The taxpayer was a limited liability company which had an individual and an S corporation as partners. The S corporation was wholly-owned by the individual partner. The individual also owned all or a majority interest in two other companies. The taxpayer purchased an airplane using a nonrecourse loan which was guaranteed by the individual and the two other companies but not the S corporation partner. The taxpayer argued that the S corporation's basis in the taxpayer was increased by the guarantees of the loan through application of the related-party rules because the individual owned the S corporation and the companies. The court held that the S corporation was not related to the guaranteeing companies sufficiently to make the S corporation liable for the guarantee of the taxpayer's loan for the purpose of increasing the S corporation's basis in the taxpayer. **IPO II v. Comm'r, 122 T.C. No. 17 (2004)**.

REFUND. The taxpayer obtained an automatic extension, to August 15, 1993, to file the taxpayer's 1992 income tax return. However, the taxpayer did not file the return until 1996. The taxpayer claimed a refund on the return which was denied by the IRS, under I.R.C. § 6511(b)(2)(A), because the return was filed more than three years after it was due. The issue was the date that the 1992 return was filed. The taxpayer claimed that the 1992 was mailed on August 16, 1996 and that the original due date was August 16, 1993 because August 15, 1993 was a Sunday and, under I.R.C. § 7503, the extension deadline could not fall on a Sunday. The court held that I.R.C. § 7503 did not apply for the purpose of determining the limitation date for a refund claim where no return was filed within the extension time; therefore, the 1992 return and included refund claim had to be filed by August 15, 1996 in order for the refund claim to be timely filed. The court noted that this holding was consistent with *Rev. Rul. 2003-41, I.R.B. 2003-17, 814*. **Weisbart v. Comm'r, 2004-1 U.S. Tax Cas. (CCH) ¶ 50,230 (E.D. N.Y. 2004)**.

RETURNS. The IRS has announced the publication on its web site of Publication 1542 (Rev. April 2004), Per Diem Rates (For Travel Within the Continental United States). The IRS announced that previously posted Publication 505, Tax Withholding and Estimated Tax, has been corrected. If Publication 505 was downloaded before April 21, 2004, the following corrections must be made: on page 44, under the heading, "How to request a waiver" under "Waiver of Penalty," in item 2, the reference to line 30 should be to line 32; in item 3, the reference to line 31 should be to line 33; in item 4, the reference to line 31 also should be to line 33. See www.irs.gov/formspubs/index.html. These publications can also be obtained by calling 1-800-TAX-FORM (1-800-829-3676).

SAFE HARBOR INTEREST RATES
May 2004

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	1.50	1.49	1.49	1.49
110 percent AFR	1.65	1.64	1.64	1.63
120 percent AFR	1.80	1.79	1.79	1.78
		Mid-term		
AFR	3.16	3.14	3.13	3.12
110 percent AFR	3.48	3.45	3.44	3.43
120 percent AFR	3.81	3.77	3.75	3.74
		Long-term		
AFR	4.65	4.60	4.57	4.56
110 percent AFR	5.12	5.06	5.03	5.01
120 percent AFR	5.60	5.52	5.48	5.46

Rev. Rul. 2004-44, I.R.B. 2004-19.

STATE REGULATION OF AGRICULTURE

PESTICIDES. The plaintiffs were a national class of farmers who purchased the herbicide Poast, manufactured by the defendant. The plaintiffs charged that the defendant fraudulently marketed Poast and a less expensive version, Poast Plus, differently even though both products were the same and both received EPA registration. Evidence showed that the defendant advertised that only Poast was registered with EPA, that the defendant used mailings, processors and dealers to warn farmers against "off-label" use of Poast Plus. Also, the defendant had state inspectors investigate the defendant's dealers for selling Poast Plus to certain crop farmers, which led to fraudulent criminal prosecutions. Evidence also showed that the defendant lied to the North Dakota Pesticide Control Board to conceal the fact that Poast Plus was EPA-registered for the same crops as Poast. The jury returned a verdict for the farmer-class awarding damages of $15,000,000. The court tripled the damages and added costs, pushing the award to $53 million. On appeal, the court affirmed the award and the certification of the class. On further review the trial court judgment was again upheld and the court added a holding that the case was not barred by FIFRA preemption because the case was based primarily on the defendant's consumer fraud in marketing two identical products as different products. **Peterson, et. al. v. BASF Corp., 675 N.W.2d 57 (Minn. 2004), *aff'g*, 657 N.W.2d 853 (Minn. Ct. App. 2003)**.

IN THE NEWS

GENETICALLY MODIFIED ORGANISMS. The plaintiff produced soybean seeds, under the brand Roundup Ready, which had been genetically modified to withstand herbicides such as Roundup. The defendant purchased some of these seeds and signed a technology agreement which prohibited the purchaser from saving the seeds for further plantings. The defendant admitted to saving the seeds from the crops and to intending to continue the practice of saving seeds for future crops. The plaintiff sought suit for patent infringement and breach of contract and sought a preliminary injunction to prohibit the defendant from using the saved seed. The trial court granted the preliminary injunction. The defendant argued that the technology agreement was an unfair restraint of trade. The trial and appellate courts held that the technology agreement was not an unfair restraint of trade because the restriction on use of seed was reasonable and did not force the defendant to purchase only Roundup Ready seed in the future. The defendant also argued that the saved seed restriction violated the doctrines of patent exhaustion and first sale. The court held that the doctrines did not apply here because there was no sale involved as to the saved seeds. Finally, the defendant argued that the saved seed restriction violated Section 2543 of the Plant Variety Protection Act (PVPA) which allows for use of saved seed. The court held that the PVPA provision did not apply to utility patents granted under the Patent Act. **See Monsanto Co. v. McFarling, 302 F.3d 1291 (Fed. Cir. 2002)**. At trial, the court ruled for the plaintiff and awarded the plaintiff $780,000 in damages which amounted to 120 times the "technology fee" which would have been collected had the saved seeds been purchased. On appeal, the appellate court reversed on the damages and remanded for recalculation of the damages. **Robert Schubert, CropChoice, April 27, 2004**.

Vermont has become the first state to require manufacturers of genetically modified seeds to label and register their products. The measure was one part of a three-pronged agricultural legislative package that also includes a bill that would make changes to water pollution rules for large farms and alter the state's right-to-farm law. Under the bill, seeds that are genetically altered or engineered must be labeled as such after Oct. 1, 2004. Seed manufacturers must report their total sales in the state to the Secretary of Agriculture every Jan. 15. **Darren M. Allen, Times Argus (Vermont), April 27, 2004**.

POULTRY PRODUCTION CONTRACTS. The Georgia legislature has passed a law governing poultry production contracts. The legislation makes such contracts voidable unless (1) the contract grower is given three days to cancel the contract and to have the contract reviewed by an attorney or advisor of the grower's choice; (2) the contract contains a provision listing the grower's rights under the new law; and (3) no chicks are delivered before all parties have signed the contract. The law also requires any integrator or processor to provide statistical data used to determine compensation to be paid the grower and gives the grower the right to be present during the weighing of poultry and feed. **Georgia House Bill 648, adding Title 2, Chapter 22**.

CITATION UPDATES

In re* Wilson, 305 B.R. 4 (N.D. Iowa 2004), *rev'g*, 296 B.R. 810 (Bankr. N.D. Iowa 2003) (exemptions) see Harl, "Are Farm Program Payments Exempt in Bankruptcy?" p. 33 *supra.

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